Integrated Risk Management (IRM)

Managing risk is an integral part of running a quality scheme and achieving good pension scheme governance.

The Pensions Regulator code of practice outlines an integrated approach to three key risk areas:

**1. THE EMPLOYER COVENANT**

An employer covenant review is an important tool that trustees should regularly consider in order for them to assess the ability of the employer to support a scheme now and in the future. The Pensions Regulator considers that a regular assessment of the covenant of a scheme is crucial in providing the trustees with an independent assessment of the scheme and will assist the trustees in discharging their duties and responsibilities to the scheme.

The specialist pensions team at Ensors are able to help trustees of schemes carry out such reviews. They are also able to apply and combine specific pension scheme knowledge with a level of financial analysis and scrutiny appropriate to the employer and the scheme to enable the trustees to assess the legal, scheme and financial aspects of the employer.

The employer covenant review is particularly important where there are doubts over the financial security of the sponsoring employer. It is also a useful tool if there is uncertainty whether the sponsoring employer is able to meet its obligations in relation to an existing recovery plan or if it is difficult for the trustees to understand the potential impact on the scheme of the employer’s future business plans.

In theory a strong employer is able to make higher contributions to the scheme over a shorter recovery period. A full assessment of the employer enables the trustees to understand fully whether they are able to make risky or rather more prudent investment decisions and also negotiate a recovery plan which is realistic and affordable to the employer.

We perform a service specifically tailored to the needs of each scheme taking into account proportionality and risk, all within a fee structure that is agreed in advance with the trustees.

In a good number of cases the review can take the form of a ‘desk review’ but still provides the trustees with a sufficiently detailed written report on the financial strength of a sponsoring or participating employer. This will enable the trustees to be able to take informed decisions in relation to the financial strength of the employer and its ability to meet obligations to the scheme.

The Pensions Regulator code of practice outlines an integrated approach to three key risk areas:

**2. INVESTMENT**

**3. FUNDING**

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The Regulator acknowledged that the additional flexibility for people with DC benefits may increase interest from members wishing to transfer from DB to DC pension schemes. They even removed the option for members of unfunded public service schemes (to avoid a mass exit.)

The Regulator recognised two headline risks:

- Members may choose to transfer their benefits when it was not in their best financial interests, and;
- A large volume of transfers could destabilise the DB scheme by crystallising liabilities.

Safeguards were implemented by introducing a legal requirement for all members with benefits of £30,000 or more to get appropriate independent advice, from a Financial Conduct Authority (FCA) authorised adviser to understand the financial implications of the transfer.

It was commonly accepted that transferring DB assets into a DC arrangement was an ill-informed choice. The concept of a member willingly giving up their guaranteed income for life, for a pot that will fluctuate with peaks and troughs in investments seemed inconceivable. Despite this fact, DB to DC transfers are at record levels.

For schemes this is becoming an effective way of de-risking by reducing their liabilities. But what are driving these transfers? Possible reasons can be found below:

- The draw of a large cash lump sum;
- High transfer values resulting largely from the decline in gilt yields;
- Concerns over the solvency of the DB scheme;
- The offering of enhanced transfer values and incentives;
- Members in poor health (the whole pot is tax free for members with a life expectancy of less than 12 months, or tax free on transfer to a spouse if death is before the age of 75.);
- Members with no dependents or spouse can take the whole pot for themselves.

However the risk to financial advisers is significant, and professional indemnity premiums are expected to rise, some advisers are reporting that some customers are insisting on transfers even if the advice is not to do that.

The FCA have taken an interest in this and are asking advisers how they are dealing with these situations, the fees they are charging for transfers and if they are giving advice in this area.

An FCA spokesman is quoted as saying:

“[The data request] is designed to help our understanding on the relative prevalence of risks in relation to insistent customers and also in relation to pension transfers. Whilst we have anecdotal evidence on these two areas, as well as data from providers, we are supplementing this quantitative data from the advisory market through this request.”

Advisers are calling for guidance and in response the FCA has published a document entitled ‘Pension reforms and insistent clients’ which was last updated in August 2017.

The document can be found on the FCA website: https://www.fca.org.uk/firms/pension-reforms-insistent-clients and gives guidance on steps to take, rules and concerns.

Defined benefit to defined contribution transfers

The freedom of choice reforms published in 2015, offered for the first time flexibility in the way individuals aged 55 and over can access their defined contribution (DC) pension savings.
**Cyber security and GDPR**

Pension trustees are data controllers and therefore responsible for protecting the schemes personal data. Cyber security prevention should be embedded into the internal control processes. The Regulator has suggested that this should be a key agenda item in trustee meetings.

In addition, the regulator has issued guidance on this matter which states:

“Pension schemes hold significant amounts of valuable data, and large volumes are often transferred to and from the employer(s), as well as advisers such as investment managers or the scheme actuary. Many schemes also offer members online access to their records, use social media and other electronic means to communicate with members. As well as ensuring members’ records are complete and accurate, you need to put controls in place to ensure the security of member data. This will help you guard against fraud and meet your obligations under data protection law.

You should work with your administrators to ensure the right controls are in place, including controls to protect against cyber security threats. This includes ensuring that anyone with access to scheme and member records is suitably vetted and trained, and requiring administrators to have measures in place to avoid any security breaches (including cyber attacks) and data losses, and a plan for dealing with these and keeping you informed if they do occur.”

As a result cyber security is now firmly on the risk register, together with the new General Data Protection Regulation (GDPR) rules that come into effect from May 2018.

The new rules replace the current Data Protection Act, and organisations can be fined for breach of the rules. The level of the fine depends on the nature of the breach. Breaches must be reported within 72 hours, and fines can be issued for failure to notify as well as for the breach itself.

Whether the fines specifically referred to in the GDPR could apply to pension schemes is unclear. The fine structure is calculated on worldwide turnover, and it is yet to be seen if this can be converted to net assets of the scheme.

It should also be noted that under the new rules the definition of ‘personal data’ is much wider than under the current Data Protection Act. It will include manual as well as digitally held data and includes data on databases, e-mail, file shares as well as mobile phones. It is also notable that the new rules apply to data controllers and data processors. What this means in practice is that ‘clouds’ will not be exempt from GDPR enforcement.

The key points for pension schemes to consider are:

- Ensure that GDPR and cyber security feature on the risk register together with the controls in place to mitigate these risks;
- Identify the categories of personal data held and determine the circumstances in which a breach would be notifiable;
- Review the cyber security measures adopted by individual trustees (or directors of a corporate trustee);
- Establish a data breach policy;
- Ensure that contracts with service providers are sufficient to cover the new GDPR rules; they should include clarification on the notification process to trustees as soon as they are aware of a breach.

**SORP 2015**

The Financial Reporting Council (FRC) have issued FRED 67 for consultation. The consultation ran until June 2017 with a final standard expected in December 2017. Following the triennial review we are expecting a review of the Pensions SORP to dovetail with this.

Procedures and practical guide (PRAG) have stated “When FRS 102 was issued in March 2013 the FRC indicated it would be reviewed every three years. The first triennial review is now in progress. The FRC is keen to hear stakeholders’ views on possible improvements to FRS 102 and there will be a number of opportunities for stakeholders to comment.”

It is expected that a revised SORP will be issued in summer 2018 with the next revision scheduled for 2020/21.

**Lifetime Allowance 2018/2019**

The lifetime allowance set by HM Revenue & Customs (HMRC) on the total value of pension benefits that an individual can receive without incurring an additional tax charge is currently £1milion for the tax year 2017/2018.

The 2018/2019 lifetime allowance is expected to be increased in line with the previous September’s Consumer Price Index (CPI), rounded to the nearest £100.

On the 17th October 2017, the Office for National Statistics announced that the CPI for September 2017 was a five year high of 3%, so with this announcement, it would seem that the lifetime allowance for 2018/2019 tax year is £1,030,000.

**IORP II**

‘IORP II’, as it is known, was finalised in January 2017 and implementation is required by January 2019. It focuses on the governance of pension schemes and their communications with members. The revision is extensive with the number of articles rising from 24 to 67.

Key changes are:

- A requirement to draw up and maintain a risk assessment;
- The appointment of a risk management function and an internal auditor;
- Documentation of a remuneration policy for key function holders; and
- Revisions to the content of annual pension benefit statements.
Pension specialists

Our pensions team have considerable experience in providing a wide range of services to pension schemes, including audit, day-to-day bank account management, preparation of statutory financial statements, pensioner payroll services, cyber security audits and employer covenant reviews. Unlike many other companies which provide accounting services to pension schemes, we are also registered auditors.

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“Barry is a great person to work with and have on your side. He is a well respected Partner at Ensors and is a leading role model for their high standards of professionalism which he delivers with clarity and a caring approach. I have worked with Barry for over 15 years as a Trustee, a Company Director and an Employee Benefits Consultant. Whether it is challenging financial issues or an audit of a pension scheme, Barry always provides a cost-effective no-nonsense approach to find successful solutions.”

Geoff Ashton – Independent Pension Scheme Trustee & Consultant

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